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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960.

No. 634

FIFTH AVENUE COACH LINES, INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

TO THE HONORABLE THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Your petitioner, Fifth Avenue Coach Lines, Inc., respectfully requests this Honorable Court to issue a writ of certiorari to the United States Court of Appeals for the Second Circuit to review the decision and judgment of that court entered in the above entitled case on July 29, 1960, pursuant to the majority opinion reversing as to one issue and affirming as to another the decision and order of The Tax Court of the United States herein.

Opinion Below.

The findings of fact and opinion of the Tax Court (R. 155-193) are reported in 31 T. C. 1080. The majority

opinion (written by Judge Clark) and the dissenting opinion (Judge Friendly) of the Court of Appeals (R. 200-220) are reported in 281 F. 2d 556.

Jurisdiction.

The judgment of the Court of Appeals was entered on July 29, 1960 (R. 222). A petition for rehearing was filed on August 12, 1960 and denied on October 10, 1960 (R. 223, 237). The jurisdiction of this Court is invoked under the provisions of 28 U. S. C. 1254.

Questions Presented.

Whether the "all events" test[1] relating to the timing of tax deductions in the case of contingent or contested liabilities required deferral of the following expenses:

1. *Interest:* A Tax Court's decision entered December 22, 1948 was accepted[2] and paid in that year, prior to expiration of the appeal period. Was it erroneous to accrue the resulting liabilities (deficiencies and interest) for certain later years which, because of the shortness of time, could not be computed and paid before the end of the year?

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[1] The Second Circuit's "all events" doctrine is based on its interpretation of *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516 (1944), and *United States* v. *Anderson*, 269 U. S. 422 (1926). Since the issues involved in this proceeding are related to the question presented in *Consolidated Edison Company of New York, Inc.* v. *United States*, 279 F. 2d 152 (2nd Cir.), now pending in this Court, certiorari granted November 14, 1960 (application of the "all events" doctrine to the timing of tax deductions in the case of payment before contest ends), if this petition is granted the Court may wish to schedule the argument to follow that in the *Consolidated Edison* case.

[2] The Tax Court made the following finding: "Petitioner had acquiesced in this Court's decision, and the liability for the interest was not being contested and was finally determined as of the end of 1948" (R. 173); in the majority opinion this finding is disregarded, but in a footnote to his dissent Judge Friendly commented, "Certainly the Tax Court's finding . . . was not clearly erroneous" (R. 216; 281 F. 2d 556, 564).

2. *Additional wages:* The taxpayer correctly determined its liability for wages for services performed by its employees during three-month periods in 1946 and also in 1948 for which the rates of compensation had not yet been fixed pending the conclusion of the periodic labor negotiations then in progress. Was the "all events" doctrine applicable to such negotiations and, if so, were the deductions for wages due to employees (based on industry compensation rates, increases in the cost of living, and other criteria) properly includible in the years in which the services were rendered instead of 1947 and 1949, the years in which the rates of compensation used in computing such deductions were confirmed by arbitration?

Statutes and Regulations Involved.

The pertinent statutory provisions and regulations are printed in the appendix, *infra*, pp. 19-21.

Statement.

I. Interest accrual.

On December 22, 1948, the Tax Court entered its decision determining deficiencies against the taxpayer aggregating $308,872.48 for 1937, 1938 and 1939 (R. 146). The principal issue decided was the cost of the taxpayer's bus franchise, a question of fact; after considering voluminous conflicting evidence the Tax Court held that the basis to be used in computing depreciation was the amount determined by the Commissioner (R. 170). The court also determined the normal useful life of the taxpayer's motor coaches and the annual depreciation allowances in respect thereof (R. 170). On the latter issue the Commissioner offered no evidence.[3] The Tax Court's determination of these deprecia-

[3] *New York City Omnibus Corporation* v. *Commissioner*, 7 TCM 899, 913.

tion issues affected the income and excess profits taxes for subsequent years (R. 170).

The taxpayer's officer in charge of tax matters conferred with its tax counsel and with the President of the Company, and it was agreed that the Tax Court's decision should not be appealed (R. 170). On December 30, 1948, the deficiencies for 1937 to 1939, inclusive, and also those for 1940 to 1942, inclusive, computed in accordance with the Tax Court's decision, aggregating $1,355,727.97, were paid (R. 171). Sometime after December 31, 1948, the Commissioner also decided not to appeal the Tax Court's decision[4] (R. 171).

The taxpayer did not pay in 1948 its tax deficiencies due and owing for 1943 and subsequent years consistent with the Tax Court's decision of December 22, 1948, but it computed and accrued both the deficiencies and interest of $109,802.30 thereon before the books were closed as of December 31, 1948 (R. 19-21, 172). The Company's failure to pay such deficiencies and interest was explained as due to the shortness of time and computation difficulties because of 1945, 1946 and 1948 carry-backs which affected 1943 and subsequent years; the amount of the 1948 loss was not ascertainable until possibly 30 days after the end of the year[5] (R. 20-21, 148).

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[4] This circumstance apparently weighed heavily with the Second Circuit's majority; we think that its significance, if any, was greatly exaggerated. In the first place, government procedures do not lend themselves to such expeditious action as would have been required for the Commissioner to determine the question of appeal by the end of 1948. Secondly, on the two issues affecting the accrual of the deficiencies and interest for 1943 and subsequent years, the Commissioner's determination was sustained as to one (franchise basis) and he offered no evidence as to the other (depreciation of motor coaches) (R. 170; *New York City Omnibus Corporation* v. *Commissioner*, *supra*, p. 913).

[5] A schedule dated January 31, 1949, reflecting the computation of the interest accrued contains notations that the tax for 1943 was affected by a 1945 carry-back, that 1944 was affected by a 1946 carry-back, and that 1946, in turn, was affected by the 1948 carry-back (R. 148).

The Tax Court concluded that the contest over the taxpayer's liability for income taxes for 1936 to 1939, inclusive, was not continued later than December 31, 1948, when the taxpayer decided not to appeal from the Tax Court's adverse decision and when these deficiencies, as well as those for the next three years, were paid, with interest (R. 170-172, 173). The liability thus accrued for income and excess profits taxes, and interest, for 1943 to 1947, inclusive, was not involved in the 1936-1939 contest, except indirectly (R. 173). No issue concerning the propriety of the taxpayer's 1948 deductions for interest paid in that year on the tax deficiencies for 1937 to 1942, inclusive, has been raised by the Commissioner. The Tax Court's finding in this case that its 1948 decision was not being contested as of the end of that year was disregarded, although not expressly overruled, in the majority opinion due to an unfortunate mistake of a critical fact.[6]

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[6] The Second Circuit's decision is based on a mistake of fact due to an unfortunate misreading of the Tax Court's opinion. The majority opinion recites (R. 203, 206): "Upon consideration of the above-mentioned evidence the Tax Court found that, although taxpayer 'did not decide not to appeal until sometime in 1949,' it 'did not contemplate appealing' as of December 31, 1948. 31 T. C. 1080, 1101. . . . While there might be exceptional situations justifying accrual prior to termination of the right to appeal, a case where the taxpayer has not decided during the taxable year whether or not to appeal is not one of them." Examination of the Tax Court's opinion discloses that it was the Commissioner (respondent) who "did not decide not to appeal until sometime in 1949" (R. 186). The taxpayer's decision not to appeal was made before December 31, 1948 (R. 55, 61). Thus in two separate places the majority based its conclusions squarely on a misinterpretation of the Tax Court's decision relative to a fundamental fact and assumed on the basis of this misconception that the taxpayer failed to decide in 1948 whether to appeal,—in direct conflict both with the Tax Court's formal findings of fact and with the facts as recited in its opinion. This error was pointed out in a petition for rehearing (R. 227-228), but the opinion was not corrected and the petition was denied (R. 237).

II. Wage accruals.

The essential facts relating to the 1946 wage accrual of $83,226.52 are as follows (Tax Court's findings, R. 163-165):

> "After the petitioner acquired the bus franchises and commenced operation of the motorized lines, it negotiated an employment contract with the union representing its employees, the first such contract being executed on July 22, 1937. Subsequently, other agreements were similarly negotiated as the previous contracts expired. In August 1946, the union presented demands for a new contract and wage increases to become effective October 1, 1946, upon expiration of the then existing contract.
>
> "On October 7, 1946, an agreement between the union and petitioner was signed which provided that any subsequent labor contract resulting from the negotiations would be retroactive to October 1, 1946, the date of expiration of the old contract. As in the case of prior wage negotiations, petitioner's employees continued to work pending an agreement as to the new wage scale, and were paid at the rates provided in the expired contract. Negotiations over the terms of the new contract had not been concluded on December 31, 1946.
>
> "Sometime prior to March 1947, petitioner closed its books for the year 1946 and accrued the additional wages which its officers estimated to be due and owing to its employees for their services from October 1 to December 31, 1946. The additional wages were estimated by petitioner's officers on the basis of their experience, the wages being paid in the industry, the increased cost of living, and other relevant facts as they existed October 1, 1946. . . .

"The amount accrued for additional wages due to the employees, $83,226.52, was computed at the rate of six cents per hour and was included in the deduction for wages in petitioner's tax return filed on March 15, 1947.

"Petitioner and the union had failed to negotiate a satisfactory agreement covering all terms of the new labor contract by the end of February 1947; accordingly, on March 7 the parties agreed to submit the matter to arbitration. Resort to arbitration in the event direct negotiations proved unsuccessful was petitioner's customary practice. There had been six previous contract terminations prior to expiration on September 30, 1946, of the agreement then in effect; in three instances the negotiations with the union were concluded directly by the parties to the negotiations and in three other instances the terms of employment had to be determined by arbitration.

"One of the issues submitted to arbitration in 1947 was the amount, if any, of a retroactive wage rate increase to be paid for the period October 1, 1946, through the end of the contract period to be fixed. . . . The petitioner's position throughout these hearings was that the union employees were not entitled to any retroactive wage increase and that an increase was not justifiable under any economic theory advanced by the union. On June 18, 1947, the arbitrator promulgated his award fixing the wage increase at an average of six cents per hour which was the amount already accrued by petitioner. In 1947 petitioner paid these additional wages covering services rendered by its employees from October 1 to December 31, 1946."

From January 1, 1937 to October 1, 1946 the wages paid by the taxpayer to its employees increased from 69¢ to $1.20 per hour, there being seven increases during a period of nine years and nine months (R. 169). During the 12

years 1937 to 1948, inclusive, there were ten increases averaging 8.1¢ per hour, as follows (R. 169):

Wage Rate	From	To
$ .69		1- 2-37
.74	1- 3-37	7-21-37
.82	7-22-37	12-31-38
.90	1- 1-39	2-28-41
.94	3- 1-41	4-30-42
1.00	5- 1-42	4-30-45
1.04	5- 1-45	2-28-46
1.20	3- 1-46	9-30-46
1.26	10- 1-46	1-31-48
1.36	2- 1-48	4-30-48
1.50	5- 1-48	6-30-49

The facts relating to the wage accrual of $112,600 claimed in the 1948 income tax return do not differ substantially[7] and need not be set forth here. The taxpayer estimated its liability for additional wages during the three months of 1948 for which the rates of compensation had not been fixed in advance at 10 cents per hour; this was the amount awarded on May 30, 1949 by the arbitrator to whom the matter was submitted on March 1, 1949, after direct negotiations failed to produce agreement (R. 168).

[7] Although the accrual in the 1948 income tax return was admitted in the Commissioner's answer (R. 74), such accrual was not entered on the books at the end of the year, the estimate of the Company's liability having been made sometime in the early part of 1949 (R. 35, 168). The failure to accrue the additional wages in closing the books was due to several causes: (a) the Company sustained a large loss (about $1,300,000) in 1948 due to having granted a wage increase of 24¢ per hour effective on May 1, 1948, the offsetting fare increases having been held up by the City and the Public Service Commission until late in the year, (b) the rate case then pending before the Public Service Commission continued until the latter part of December, and (c) such accruals were not includible in the statements prepared for the Public Service Commission sometime in the latter part of 1948 (before the problem of year-end accruals and other adjustments would have been considered) (R. 35, 37, 77).

In addition to the Tax Court's detailed evidentiary findings as summarized above, it made an ultimate finding or conclusion that the liabilities for the 1946 and 1948 additional wages were contested and thus contingent at the end of those years (R. 169).[8] The majority of the Second Circuit applied its "all events" theory to this issue also and sustained the Tax Court's deferment of the wage deductions to 1947 and 1949 (R. 206-212). Under the majority view, the periodic employer-employee labor negotiations constituted "contests" in that, at the end of 1946 and 1948, the taxpayer was "contesting" the wage demands of its employees by bargaining with them (R. 169, 208). The taxpayer's deductions, representing its determination of its liabilities at the end of the respective years, were rejected, though later proven to have been exactly correct, on the ground that the reasonableness of the accruals had not and could not have been demonstrated at the trial of this case except by introducing evidence co-extensive with that submitted in the subsequent arbitration proceedings (R. 219). Judge Friendly dissented on the ground that the liabilities were incurred in the years in which accrued, that the amounts of the wages were capable of reasonable approximation, as shown by the absolute accuracy of the estimates, and that to compare ordinary wage negotiations or arbitrations with

[8] We submit that this ultimate finding or conclusion is unfounded on the basis of the trial court's other findings of fact on which it is bottomed. The undisputed evidence shows that the taxpayer agreed in writing to pay its employees whatever wages were finally fixed, that the wage negotiations were still pending at the end of 1946 and 1948, that direct negotiations were successful without resort to arbitration half of the time, and that it was not until March of 1947 and 1949 that the parties resorted to arbitration (R. 163-164). Although the labor negotiations necessarily involved resistance to excessive demands, such resistance is a part of the bargaining process and does not become a "contest" of the kind considered by this Court in the *Dixie Pine* case, *supra*, and in *Security Flour Mills Company* v. *Commissioner*, 321 U. S. 281 (1944).

litigations over taxes or other contested liabilities is unrealistic (R. 217-218). Accordingly, he concluded that "the deduction of a reasonable estimate of this expense comes far closer to the clear reflection of income demanded by §41 of the 1939 Code than making none" (R. 219).

Reasons for Granting the Writ.

1. The decision below presents an important question of Federal law which has not been but should be settled by this Court. As pointed out in Judge Friendly's dissenting opinion, citing recent articles in the law reviews of New York University, the University of Michigan, and the University of Chicago, tax men now refer to this area of tax law dealing with the timing of income and deductions as a 'jungle' (R. 213).

In *United States* v. *Anderson, supra,* this Court held that liabilities incurred and susceptible of reasonable estimate were deductible by accrual basis taxpayers. In the *Dixie Pine* and *Security Flour Mills* cases, both *supra,* the doctrine of the *Anderson* case was limited and held inapplicable to contingent and contested liabilities (cases involving State gasoline tax and Federal processing tax litigations). In the decision below, the Second Circuit further limits the doctrine of the *Anderson* case and extends *pro tanto* the doctrine of the *Dixie Pine* and *Security Flour Mills* cases to embrace far wider areas than the contests involved in those proceedings. Relative to the interest accrued by the instant taxpayer as of December 31, 1948, the court below holds in effect that in litigated cases the contest continues until the time for appeal expires even though the judgment debtor decides not to appeal and pays the judgment. Relative to the liabilities for 1946 and 1948 wages, the majority of the court below holds in effect that routine, periodic labor

negotiations constitute such a dispute or contest as to bring the additional wages incurred for services rendered after termination of the previous contract within the doctrine of the *Dixie Pine* decision.

That this Court is concerned with the confusion surrounding the timing of tax deductions is evident in that certiorari has been granted to review the Second Circuit's opinion in the *Consolidated Edison Company* case, *supra*, involving contested real estate taxes paid prior to termination of the dispute. Whether or not the Second Circuit's "all events" yardstick was properly applicable in that case, it is noted that the issue there related to taxes in litigation; to that extent the case involved a real contest and is similar to the *Dixie Pine* and *Security Flour Mills* cases. It is submitted, however, that in the interest of the matching of costs and expenses against income in keeping with the objective of the applicable Treasury regulations,[9] the "all events" doctrine of contested liabilities such as those involved in *Dixie Pine* and *Security Flour Mills* should not be extended. Instead, that principle should be limited in its application to cases of litigation, or of substantial dispute. Here, the written agreements between employer and employees followed by the performance of services by the employees, created bona fide liabilities which would have been enforceable on a *quantum meruit* basis if the parties had not, in keeping with their practice, resorted to the more expeditious[10] arbitration procedures to fix the amount thereof. Except in extraordinary situations, liabilities which are known or capable of reasonable estimate should be accrued in the years in which incurred. Although theoretical considerations may sometimes outweigh the prac-

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[9] Treasury Regulations 111, Sec. 29.43-2, appendix *infra*, pp. 20-21.

[10] Both the 1947 and 1949 arbitrations lasted approximately three months (R. 164-165, 168).

tical, it is submitted that with respect to the accrual of expenses legalistic theories should not be allowed to become a strait-jacket of inflexibility to create unnecessary distortions.[11]

2. The decision below is in conflict with decisions of other circuit courts. In *Milwaukee & Suburban Transport Corp.* v. *Commissioner*, 283 F. 2d 279 (1960), the Seventh Circuit, reversing the Tax Court, held that the taxpayer, an operator of a passenger transportation line, might estimate and accrue its liability for potential and unsettled injuries and damages. The Tax Court's determination that the estimates were not deductible on the ground that the claims were being contested and that the amount of the liability was not ascertainable with reasonable certainty was deemed untenable. The appellate court concluded that the extensive experience of the taxpayer permitted it to estimate with reasonable accuracy the amount of the overall reserve even though such reserve may have been inaccurate with respect to the individual claims.

Many other decisions have similarly held that the accrual of expenses is proper if liability exists even though the amount must be based on estimates. Prior to the instant decision, the Second Circuit had sanctioned the accrual of expenses incurred for storage charges and brokerage commissions although recognizing that there were contingencies and uncertainties which might result

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[11] To point up the harsh consequences of the refusal to allow estimated accruals of the wages, let us assume that the written stipulations between the taxpayer and its employees had provided that they were to be paid at industry rates (instead of at rates to be negotiated later), would the Commissioner still refuse to allow accruals based on estimates? Or, assume that the stipulations had provided that all wages for services during labor negotiations would be paid when the rate should be finally fixed, would the Commissioner still refuse to allow accruals for services rendered during the taxable period?

in the nonpayment or forfeiture of the brokers' commissions. *Central Cuba Sugar Co.* v. *Commissioner*, 198 F. 2d 214 (1952), rev'g and aff'g in part 16 T. C. 882. Other circuits have been even more liberal and have permitted deductions for costs or work to be performed in subsequent years, provided only that the amount of the liability could be reasonably estimated. Thus in *Denise Coal Company, et al.* v. *Commissioner*, 271 F. 2d 930 (3rd Cir. 1959), rev'g 29 T. C. 528, estimated expenses involving future expenditures to replace the over-burden after strip-mine operations were allowed. In *Schuessler* v. *Commissioner*, 230 F. 2d 722 (5th Cir. 1956), rev'g 24 T. C. 247, a reserve to carry out guarantees was held to be deductible. In *Pacific Grape Products Co.* v. *Commissioner*, 219 F. 2d 862 (9th Cir. 1955), rev'g 17 T. C. 1097, both income and expenses relating to the sale of fungible goods and including the estimated costs of labeling and preparing for shipment (although shipping instructions had not been issued) were deemed proper accruals. In *Patsch* v. *Commissioner*, 208 F. 2d 532 (3rd Cir. 1954) and in *Harrold* v. *Commissioner*, 192 F. 2d 1002 (4th Cir. 1951), rev'g 16 T. C. 134, the estimated cost of backfilling strip-mine land was allowed. Although in *Spencer, White & Prentis, Inc.* v. *Commissioner*, 144 F. 2d 45 (1944), the Second Circuit had earlier disallowed deductions for the estimated cost of future restoration work, the decision of that case may have been based, in part at least, on the taxpayer's failure to establish the reasonableness of its expense estimates.

Probably mention should be made of a related question on which there exists a conflict of authority, namely, whether an accrual basis taxpayer may defer part of its prepaid income—from dues, service charges, etc.—to a later year in keeping with the contract period. Whether or not the deferral of such prepaid income which has not been earned

is permissible (the Government opposes such deferment), in our opinion there is no valid reason for refusing to permit the accrual of ordinary operating expenses. It would seem that many of the arguments urged by government counsel for opposing deferment of prepaid income to a later year for tax purposes would support our contentions here against the deferment of expenses already incurred. This Court recently granted certiorari in the case, *American Automobile Association* v. *United States*, 181 F. Supp. 255 (1960), in which the Court of Claims refused to permit the deferral of prepaid membership dues by an automobile club on the basis of this Court's decision in the case, *Automobile Club of Michigan* v. *Commissioner*, 353 U. S. 180 (1957), in which the entire amount of the automobile club's annual dues were taxed in the year of receipt. However, the Eighth Circuit, in *Schlude* v. *Commissioner*, 283 F. 2d 234 (1960), has now held that a reasonable portion of the fees of a dancing studio pertaining to instructions to be given in the year following receipt need not be included in income in the year of receipt. The Second Circuit is in agreement. *Bressner Radio, Inc.* v. *Commissioner*, 267 F. 2d 520 (1959) (prepaid TV charges covering service contracts for 12-month periods). Note, however, the Seventh Circuit's decision in *Streight Radio and Television, Inc.* v. *Commissioner*, 280 F. 2d 883 (1960), application for certiorari pending, holding that income from TV service contracts could not be deferred in proportion to the number of months the contracts extended into the following year.

3. The decision of the court below is not in harmony with decisions of this Court. In *United States* v. *Anderson*, *supra* (p. 441), and in *Continental Tie & Lumber Co.* v. *United States*, 286 U. S. 290, 297, this Court held that

the deduction of expenses or costs incurred is not defeated by the inability to make an exact calculation during the year in which the liability is incurred. The doctrine of these cases is not to be confused with the holding in *Lucas* v. *American Code Company, Inc.*, 280 U. S. 445 (1930), in which this Court refused to sanction the accrual of a deduction for its breach of a contract pending the outcome of the litigation with a former officer. Although the taxpayer in that case attempted to set up a reserve, it was of course without a yardstick or criteria by which to determine the ultimate outcome or the damages that would be awarded. Note also this Court's decision in *Brown* v. *Helvering*, 291 U. S. 193 (1934), denying deductions based on anticipated cancellations of insurance policies. In the latter case, all the events on which liability depended (the cancellations) had not occurred and were contingent. Unlike those cases, here all the events necessary to the computation of the taxpayer's liability had occurred by the end of the taxable periods involved and it was on the basis of the facts then known to or ascertainable by the taxpayer's officers that the amounts of the interest and additional wages were determined and deducted. The facts bearing upon the value of the services of the taxpayer's employees were later considered by the arbitrators and it is significant that both the Company's officers and the arbitrators, on the basis of these facts, reached the same determination.

'We doubt, moreover, that the decision below is in harmony with the views expressed by this Court in *Fawcus Machine Co.* v. *United States*, 282 U. S. 375 (1931), where the amount of the tax liability for 1918 was adjusted as of December 31, 1918 on the basis of a retroactive change in the revenue laws enacted in February 1919. The principle that events having retroactive effect which occur

shortly after the close of the taxable period may be related back where necessary to prevent the understatement of one's liabilities is another ground justifying the accrual in 1948 of the instant interest (and tax deficiencies) based on the 1948 court decision relating to other years, the appeal period having expired in the following year without an appeal being taken. This principle seems applicable also to the additional wages the liabilities for which were incurred in 1946 and 1948 under the rules of evidence relative to the corroborating effect of subsequent events, the amounts having been confirmed by the retroactive arbitration awards handed down in May and June of the following years.

In this connection attention is invited to the fact that under the prevailing view below disallowing the wage accruals the commencement of the arbitration proceedings in March of 1947 and 1949 seems to have been related back; otherwise it is difficult to rationalize the inference or conclusion that routine and regularly recurring labor negotiations, which were successful as often as not without resort to arbitration, were "contests". If it be proper to relate back the commencement of arbitration to support an inference of contest, it should be equally proper to relate back the arbitration awards handed down approximately three months later corroborating the amount of the liabilities.

4. The majority decision of the court below departs so far from the course of judicial proceedings prescribed by this Court as to call for this Court's exercise of its powers of supervision. In *Commissioner* v. *Duberstein, et al.* and *Stanton, et al.* v. *U. S.*, 363 U. S. 278, remanding decisions of the Second Circuit, this Court clearly and unequivocally set metes and bounds on the powers of reviewing courts to reject or disregard the findings of trial courts. In the

instant case the majority opinion, while not expressly overruling the ultimate findings of fact of the Tax Court on the issue concerning the interest accrued in 1948 (finding that the contest was not continued after 1948, R. 173), nevertheless disregarded such finding and predicated its opinion reversing the Tax Court on an assumed fact squarely opposed to the finding of the trial court. The reviewing court misinterpreted the statement of a critical fact in the Tax Court's opinion (see footnote 6, *supra*); the decision reversing the Tax Court is predicated largely on this unfortunate mistake. The importance attached to the assumed fact is evident in that it is twice repeated in the majority opinion. Although the error was of course inadvertent, the failure of the reviewing court to correct its decision when the mistake was called to its attention (petition for rehearing, R. 226-228) is not consonant with the standards of justice insisted upon by this Court.

The Tax Court's finding that the contest did not extend after payment of the deficiencies in 1948 is consistent with *Landers, Frary & Clark* v. *United States*, 149 F. Supp. 202 (1957), which involved the payment of proposed deficiencies in 1946 prior to the Commissioner's approval and assessment of such deficiencies in 1947. The Court of Claims stated (p. 872), "When the taxpayer no longer contests, but admits liability, the tax accrues," and observed (p. 873), "it is the recognition of the liability that causes the accrual." We submit that the views of the Tax Court here and of the Court of Claims in *Landers, Frary & Clark* are correct; it follows that the conclusions reached by the majority of the Second Circuit in the decision below are invalid.

Conclusion.

The taxpayer's acceptance and payment in 1948 of certain deficiencies determined by the Tax Court late in that year and its further payment of as many of the deficiencies for later years as it was able to recompute before December 31, 1948 justified its deduction of the interest accrued in 1948 on the unpaid deficiencies for 1943 to 1947, inclusive. The taxpayer's regularly recurring labor negotiations were not a "contest" such as to preclude the accrual of reasonable estimates of its liability for wages performed during the taxable years 1946 and 1948 pursuant to an agreement which left the rate of compensation open pending the outcome of the negotiations.

Wherefore, your petitioner respectfully prays that its petition for a writ of certiorari be granted.

Respectfully submitted,

PAUL R. RUSSELL,
Counsel for Petitioner,
20 Exchange Place,
New York 5, N. Y.

SHEARMAN & STERLING & WRIGHT.

January 6, 1961.

APPENDIX.

Internal Revenue Code (1939).

* * * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

Treasury Regulations 111.

Sec. 29.41-1. Computation of net income—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of

which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. • • •

Sec. 29.43-1. "Paid or incurred" and "paid or accrued" —(a) The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48(c).) The deductions and credits provided for in chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Internal Revenue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable. • • •

• • • • • •

Sec. 29.43-2. When charges deductible—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return.

The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. • • •

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960.

No. 634.

FIFTH AVENUE COACH LINES, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

APPENDIX TO PETITION FOR WRIT OF CERTIORARI.

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* For convenience of reference the opinions of the United States Court of Appeals for the Second Circuit and the judgment have been given the same page numbers in this appendix to the petition for writ of certiorari as in the official record as certified by the Clerk of that Court.

Opinion of United States Court of Appeals for the Second Circuit (Judge Clark).

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 271—October Term, 1959.

(Argued April 11, 1960 Decided July 29, 1960.)

Docket No. 25986

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

—v.—

FIFTH AVENUE COACH LINES, INC.,
Respondent.

FIFTH AVENUE COACH LINES, INC.,
Petitioner,

—v.—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Before:

SWAN, CLARK and FRIENDLY,
Circuit Judges.

Both the Commissioner of Internal Revenue and the taxpayer, Fifth Avenue Coach Lines, Inc., petition for review of a decision of the Tax Court of the United States, Russell E. Train, *Judge*, reviewed by the full court, 31 T. C. 1080, finding certain deficiencies and refusing to find other deficiencies in the taxpayer's income and excess

profits taxes for specified years. Reversed on the Commissioner's petition; affirmed on the taxpayer's cross-petition.

WILLIAM J. HOWARD, Atty., Dept. of Justice, Washington, D. C. (Charles K. Rice, Asst. Atty. Gen., and Lee A. Jackson and Harry Baum, Attys., Dept. of Justice, Washington, D. C., on the brief), *for Commissioner of Internal Revenue.*

PAUL R. RUSSELL, of Shearman & Sterling & Wright, New York City, *for taxpayer.*

CLARK, *Circuit Judge:*

These are petitions by both the Commissioner of Internal Revenue and the taxpayer for review of a Tax Court decision, 31 T. C. 1080, sustaining in part only determinations of deficiencies in the taxpayer's income taxes for the years 1943 to 1947 and excess profits tax for the year 1943. The taxable year 1948 is involved only in so far as the earlier years are affected by a net operating loss deduction from 1948 and a carry-back of unused excess profits credits. Taxpayer, an operator of motor coaches in Manhattan, reports its income on a calendar year accrual basis. Both petitions require a determination of the year in which certain deductions, to which taxpayer is concededly entitled, accrued for tax purposes.

I. *The Commissioner's Petition for Review*

The Commissioner seeks review of the Tax Court's allowance of a deduction for unpaid interest on certain tax deficiencies. The question arises from earlier litigation in the Tax Court which determined deficiencies for the years

1937 to 1939. Taxpayer's income and excess profits taxes for the years 1940 to 1947 were also affected by the determination, as the major item in dispute was the cost basis of its bus franchise for amortization purposes. See *C. I. R.* v. *Sunnen*, 333 U. S. 591. The Tax Court rendered its opinion in the case on November 30, 1948, and the decision was formally entered on December 22, 1948. *New York City Omnibus Corp.* v. *C. I. R.*, 17 P-H Tax Ct. Mem. 803 (1948). The court found that the cost basis of the franchise was that determined in the deficiency notice, upheld the Commissioner as to the date on which amortization should commence, and upheld the taxpayer as to the longevity of its motor buses, the taxability of net earnings which taxpayer was required by court order to turn over to another company, and the deductibility of a reserve for accident and damage claims. Since neither the Commissioner nor the taxpayer appealed, the Tax Court decision became final on March 22, 1949. See I. R. C. 1939, §§1140, 1142.

On December 30, 1948, the taxpayer mailed certified checks totaling $1,355,727.97 to the Collector of Internal Revenue. This amount represented deficiencies and interest for the years 1937 to 1942. Taxpayer also accrued on its books and deducted on its 1948 tax return the amount of $109,802.30 as interest on deficiencies for the years 1943 to 1947. It is this accrual which is here in issue. The Tax Court found that, although there was no clear admission of liability by reason of the payments in 1948,[1] it was extremely unlikely that the decision would be appealed. From

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[1] The effect of the remittance would be to stop the running of interest on the particular deficiencies, but it would not preclude the taxpayer from continuing the litigation. See I. R. C. 1939, §§292, 1145, 1146. See also *Lewyt Corp.* v. *C. I. R.*, 2 Cir., 215 F. 2d 518, modified on other grounds, 349 U. S. 237; *Rosenman* v. *United States*, 323 U. S. 658; *Arheit* v. *C. I. R.*, 31 T. C. 46.

this it concluded that the interest liability resulting from the 1948 decision was substantially fixed and unconditional in that year, so that accrual of the expense was justified. The decision was written by Judge Train and was reviewed and accepted by the full court, but Judge Harron filed a dissenting opinion, 31 T. C. 1080, 1104, with which we find ourselves in accord.

On the issue of likelihood of appeal there was evidence that prior to December 31, 1948, taxpayer's comptroller-vice president, after conferring with tax counsel, advised its president that an appeal should not be prosecuted. The minutes of a meeting of the board of directors on February 25, 1949, disclosed a statement by a board member that an appeal should not be prosecuted unless the Commissioner appealed, in which event a cross-appeal should be filed. This board member, the senior partner of a law firm representing taxpayer in tax matters, although not in the particular litigation, indicated that he had previously recommended this course to taxpayer's officers. The Tax Court also stressed the fact that its 1948 decision respecting the cost basis of the bus franchise "was based on findings of fact established by voluminous conflicting evidence," 31 T. C. 1080, 1102, although it should be noted that the court specifically had refused to include in the cost basis a number of items for which the taxpayer had contended. Upon consideration of the above-mentioned evidence the Tax Court found that, although taxpayer "did not decide not to appeal until sometime in 1949," it "did not contemplate appealing" as of December 31, 1948. 31 T. C. 1080, 1101.

While we agree that as of the end of the year 1948 it was more likely that taxpayer would not appeal than the contrary, it is unnecessary to decide the degree of remoteness of the probability of appeal, since we are of the opinion that the test adopted by the Tax Court was erroneous. The controlling principle is that enunciated by the Supreme

Court in *Dixie Pine Products Co.* v. *C. I. R.*, 320 U. S. 516, 519: "It has long been held that in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid; and this cannot be the case where the liability is contingent and is contested by the taxpayer. * * * [The taxpayer must] await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated."

We think it clear that taxpayer's liability for the tax deficiencies, and thus the interest thereon, was not "finally adjudicated" in 1948. As the Ninth Circuit concluded in *H. Liebes & Co.* v. *C. I. R.*, 9 Cir., 90 F. 2d 932, 938, "If appeal is taken, the right is not fixed until determination of the appeal; and if no appeal is taken, * * * the right becomes fixed on termination of the appeal time." Or as picturesquely stated in *United States* v. *Texas Mexican Ry. Co.*, 5 Cir., 263 F. 2d 31, 34, "the existence of any liability is uncertain until the last bell is rung in the last court."[2] See also *United States* v. *Safety Car Heating & Lighting Co.*, 297 U. S. 88; *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417; *Lynch's Estate* v. *C. I. R.*, 2 Cir., 150 F. 2d 747, 162 A. L. R. 313, certiorari denied 326 U. S. 780. To

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[2] *Columbus & Southern Ohio Elec. Co.* v. *C. I. R.*, 26 T. C. 722, affirmed *per curiam* 6 Cir., 244 F. 2d 79, certiorari denied 355 U. S. 822, relied upon by taxpayer, is not contrary to the view we here adopt. There taxpayer in 1949 petitioned the Ohio Public Utilities Commission to review the electricity rate schedule adopted by the City Council and approved by the electors of Columbus, Ohio. In 1950 the taxpayer accepted in writing a compromise schedule adopted by the Council and approved by the electorate, and further agreed to join with the city in submitting a stipulated compromise order to the Public Utilities Commission. It was held that the refunds required by the compromise agreement accrued in 1950, although the formal and apparently *pro forma* approval of the Commission was not obtained until February 7, 1951, four days after the stipulation was filed.

the extent that accounting principles are persuasive,[3] we note that the American Institute of Accountants has voiced its approval of the rule that contested or litigated liabilities such as tax deficiencies are deductible in the year in which the contest is resolved. See *Recommendations to Congress by the American Institute of Accountants Regarding Divergencies Between Rules of Tax Accounting and Generally Accepted Accounting Principles*, 97 J. Accountancy 93, 96 (1954).

While such a determinate standard might be deemed mechanical, by the same token it offers a clear guide to the taxpayer, promotes ease of administration, and contributes to the certainty of the revenue. Slight difficulty is imposed upon a taxpayer who desires an earlier deduction, since the right to appeal can be relinquished at any time by notifying the Commissioner of acquiescence. We thus see neither theoretical nor practical justification for introducing the complexities involved in determining reasonableness of expectation of appeal. As Judge Harron noted in her dissent, the decision therein would permit a taxpayer to choose the most advantageous year for accruing a deduction. Certainly taxpayer could have deducted the interest payment in 1949 without encountering any opposition from the Commissioner. The opportunity for manipulation is enhanced where, as here, taxpayer relies primarily upon evidence of private conversations among its officers, uncommunicated to any third party. The Supreme Court has continually denied both the Government and the taxpayer "the privilege of allocating income or outgo to a year other than the year • • • in which the right to receive, or the obligation to pay, has become final and definite in amount." *Security*

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[3] For a recognition of the differing attitudes and objectives of tax accounting and standard accounting practice, see Emery, *Time for Accrual of Income and Expenses*, 17 N. Y. U. Institute on Federal Taxation 183 (1959).

Flour Mills Co. v. *C. I. R.*, 321 U. S. 281, 286-287. While there might be exceptional situations justifying accrual prior to termination of the right to appeal, a case where the taxpayer has not decided during the taxable year whether or not to appeal is not one of them.

II. *The Taxpayer's Petition for Review*

The taxpayer seeks review of the Tax Court's disallowance of an accrual for contested wage claims in the years 1946 and 1948. Taxpayer and the Transport Workers Union of America, which represented its employees, were parties to a collective bargaining agreement which expired on September 30, 1946. Prior to and following this date the parties were unable to reach agreement as to a new wage scale, but in order to continue operations they agreed on October 7, 1946, that any subsequent contract resulting from the negotiations would be retroactive to October 1, 1946. In the interim the employees continued to work at the wage scale provided in the expired contract. Negotiations continued without success until March 7, 1947, when the parties agreed to submit the dispute to arbitration. The union sought a 25-cent-per-hour increase, while the taxpayer insisted that no increase was justified. On June 18, 1947, the arbitrator promulgated his award which, *inter alia*, granted a wage increase of 6 cents per hour, retroactive to October 1, 1946.

This agreement arrived at by arbitration expired on January 31, 1948. The parties again were unable to agree upon new terms, and on January 26, 1948, they entered into an agreement similar to that of October 7, 1946. Subsequently the taxpayer agreed to a wage increase effective May 1, 1948, on the condition that the city grant a fare increase. This condition was fulfilled and petitioner increased wages by 24 cents per hour. The question of additional compensa-

tion for the interim period remained a matter of dispute, however, and the matter was finally submitted to arbitration on March 1, 1949. The union urged that the 24-cent-per-hour increase be applied retroactively, while the taxpayer adopted the position that no back pay award should be granted. On May 30, 1949, the arbitrator determined that the employees were entitled to an additional 10 cents per hour for the period February 1 to April 30, 1948.

These retroactive wage increases of 6 and 10 cents per hour were accurately estimated by taxpayer, which deducted the additional amounts as accrued wage expense in its tax returns for 1946 and 1948.[4] The Commissioner refused to allow these deductions on the ground that the taxpayer had been actively contesting the union demands, so that neither liability nor the amount thereof was reasonably established at the end of the taxable years. Taxpayer relied upon the fact that it had contracted to pay any increase that should be determined, contended that it always recognized its obligation to pay just compensation for the services rendered, and maintained that its officers were able accurately to estimate the amount of the increases. Judge Train's decision sustaining the Commissioner was upheld by the full court without dissent. 31 T. C. 1080.

The principle that liabilities are deductible for tax purposes only in the year in which all the events occur which fix the amount and determine the liability to pay was originally adopted in *United States* v. *Anderson*, 269 U. S. 422. While the "all-events test" has been liberalized in certain respects, it has been consistently applied to deny tax recog-

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[4] The accrual for 1946 was determined sometime prior to March 1947, when taxpayer closed its books for the year 1946. The estimated liability for 1948 was not accrued upon taxpayer's books, but was determined prior to the filing of its 1948 income tax return on May 13, 1949. Presumably the contingency appeared as a footnote in its annual report. It thus appears that taxpayer did not follow any uniform corporate accounting procedure in regard to such claims.

nition to a liability as long as it remains contested and thus contingent. As succinctly stated in *Security Flour Mills Co.* v. *C. I. R., supra,* 321 U. S. 281, 284, "It is settled by many decisions that a taxpayer may not accrue an expense the amount of which is unsettled or the liability for which is contingent, and this principle is fully applicable to a tax, liability for which the taxpayer denies, and payment whereof he is contesting." To the same effect are *Dixie Pine Products Co.* v. *C. I. R.,* 320 U. S. 516, 519, quoted *supra; Lucas* v. *American Code Co.,* 280 U. S. 445, 67 A. L. R. 1010; *United States* v. *Minneapolis & St. Louis Ry. Co.,* 8 Cir., 260 F. 2d 663, 669; *Rose* v. *United States,* 3 Cir., 256 F. 2d 223; *Ismert-Hincke Milling Co.* v. *United States,* 10 Cir., 246 F. 2d 754; *Brainard Steel Corp.* v. *United States,* Ct. Cl., 146 F. Supp. 461; *Atlantic Coast Line R. Co.* v. *C. I. R.* 4 T. C. 140. See also *Cuba R. Co.* v. *United States,* 2 Cir., 254 F. 2d 280, certiorari denied 358 U. S. 840; *Jamaica Water Supply Co.* v. *C. I. R.,* 2 Cir., 125 F. 2d 512, certiorari denied 316 U. S. 698. Nor has our attention been directed to any case permitting the deduction of a contested liability.

Taxpayer, however, urges that it was not denying liability, but was merely engaging in customary bargaining over the amount of a recognized liability, and that it adopted as a negotiating stratagem the position that no wage increase was justified. While recognizing the plausibility of this contention, we think it proves too much, since in effect we are asked to emasculate the well-established principle that contested liabilities are nondeductible. This answer was cogently advanced by the Tax Court in the following words: "[I]t must be appreciated that, realistically, where a party to any legal proceeding, realizing that in all probability its case will not be entirely successful, denies any liability, it does so for much the same reasons that the petitioner here contends motivated it to deny liability in the arbitration

proceedings. Although a party in such a case might realize its chances of success are slight, it has nonetheless contested the alleged liability. Taxation is a practical matter; the rule that has become the law and proved workable is that truly contested liabilities are not accruable and deductible. The petitioner would have us develop an exception that would be quite impractical of application, and one that would create a departure from the usual concept of what constitutes contesting a liability." 31 T. C. 1080, 1097.

We need not, however, rest decision solely upon the inconsistent positions adopted by the taxpayer. Aside from the *post hoc* verification of taxpayer's estimates, which under our system of annual returns is not entitled to consideration, the evidence was insufficient to demonstrate that such figures could be determined with reasonably predictable accuracy. If any showing of the complex and uncertain nature of the collective bargaining process and of arbitration proceedings which are an extension thereof is required, it may be found in the following extracts from the awards granted herein in 1947 and 1949 respectively:

> "At the outset, the arbitrator believes there is no simple formula or no set of rules which will uniquely and directly determine the wage dispute in this case. The parties have introduced all the standard arguments for and against a wage increase—cost of living, ability to pay, prevailing rates and productivity. They have developed, with considerable imagination, other arguments peculiar to the distinctive facts of this case. The task of the arbitrator under these circumstances must be one of balancing conflicting theories, assigning weight to various arguments, and evaluating the significance of particular facts." 31 T. C. 1080, 1087-1088.

"The Arbitrator has not attempted to note all the arguments made by the respective parties for or against an increase in wages for the three-month period in question. * * * The conclusion on this issue as hereinafter noted is based on many factors which are inextricably related. An arbitration relating to wages and many other issues is not conducted in a vacuum. The decision cannot be reached by the application of a precise mathematical formula and there is obviously no slide-rule method upon which such a determination can be based." 31 T. C. 1080, 1089-1090.

It should also be noted that the determination of a wage schedule was complicated by differences between the parties on a number of other issues. Thus in the 1947 proceeding the union sought the establishment of a pension plan which the arbitrator granted, while noting that this decision would affect the wage determination.

The prospective wage rates were estimated by two of taxpayer's officers "on the basis of their experience, the wages being paid in the industry, the increased cost of living, and other relevant facts." 31 T. C. 1080, 1087. But we are not enlightened as to how the Commissioner or the courts are able to judge the accuracy of these unilaterally determined, subjective appraisals. For aught that appears, an estimate of one-half or of double the amount submitted would be equally unassailable. The 1947 arbitration proceeding required 22 days of hearings; and a similar quantum of evidence would seem requisite to arrive at an informed judgment as to the reasonableness of taxpayer's estimates. Even aside from the obvious impracticality of litigating before the Commissioner and the Tax Court the amount of compensation to which employees are entitled, it seems doubtful whether the result thereof would amount to more than an educated guess. See *United States* v. *Delta*

Air Lines, Inc., 5 Cir., 255 F. 2d 501, certiorari denied 358 U. S. 882. Further, if the taxpayer had deemed the deductions more advantageous in 1947 and 1949, the Commissioner certainly would have been unable to demonstrate that a reasonable estimate could have been reached in 1946 and 1948. Thus in practical effect the taxpayer seeks an option to deduct such amounts in whichever taxable year is the more favorable.

Reliance is placed by the taxpayer upon a number of recent cases in the courts of appeals which reflect a liberal trend toward permitting the accrual of reasonably ascertainable liabilities in order to equate the expenses incurred in producing current income with such income. While we find ourselves in general accord with such authority, none of these opinions support the deduction here sought. Thus the accrual of brokerage fees, labeling, packaging, and shipping costs to be incurred as a result of sales of canned goods during the taxable year was approved in *Pacific Grape Products Co.* v. *C. I. R.*, 9 Cir., 219 F. 2d 862, 868, where the taxpayer demonstrated "that the items making up these expenses were either precisely known or determinable with extreme accuracy." Similarly in *Central Cuba Sugar Co.* v. *C. I. R.*, 2 Cir., 198 F. 2d 214, certiorari denied 344 U. S. 874, a deduction for accrued brokerage commissions was allowed, since the amount thereof was fixed, subject only to "insubstantial" adjustments.

In *Denise Coal Co.* v. *C. I. R.*, 3 Cir., 271 F. 2d 930, taxpayer, a coal mine operator under a statutory duty to refill and rehabilitate land devastated by its strip mining, set up a reserve for such liability based upon detailed engineering studies verified by the estimates of independent contractors. Upon this evidence of the reasonable accuracy of the estimate, the court held that accrual was proper. To similar effect is *Harrold* v. *C. I. R.*, 4 Cir., 192 F. 2d 1002. These same circuits, however, have not hesitated to deny

a deduction for similar liabilities where there was an inadequate demonstration of reasonable accuracy. See *Jenkins* v. *C. I. R.*, 3 Cir., 217 F. 2d 951; *C. I. R.* v. *Gregory Run Coal Co.*, 4 Cir., 212 F. 2d 52, certiorari denied *Gregory Run Coal Co.* v. *C. I. R.*, 348 U. S. 828; *Patsch* v. *C. I. R.*, 3 Cir., 208 F. 2d 532.

An analogous distinction was recently adopted by this court in *Bressner Radio, Inc.* v. *C. I. R.*, 2 Cir., 267 F. 2d 520, 528, involving the deferral of prepaid income. There, in contrast to *Automobile Club of Michigan* v. *C. I. R.*, 353 U. S. 180, the court was convinced that the method of deferral was reasonably accurate. The taxpayer, "[d]rawing on its experience with thousands of contracts • • • demonstrated that it was subjected to a reasonably uniform demand for services, so that it could and did anticipate that the expenses incident to the performance which alone would entitle it to regard the sum received as earned would be distributed across the life of the contract." *Schuessler* v. *C. I. R.*, 5 Cir., 230 F. 2d 722, and *Beacon Pub. Co.* v. *C. I. R.*, 10 Cir., 218 F. 2d 697, illustrate the same principle. No such evidence of reasonably predictable accuracy has here been adduced. See also *Capital Warehouse Co.* v. *C. I. R.*, 8 Cir., 171 F. 2d 395; *Spencer, White & Prentis, Inc.* v. *C. I. R.*, 2 Cir., 144 F. 2d 45, certiorari denied 323 U. S. 780. The situation here presented may be contrasted with that considered by this court in *Consolidated Edison Co. of New York* v. *C. I. R.*, 2 Cir., May 25, 1960, which involved a deduction for contested real estate taxes. Although the court was there divided as to the effect of *payment* of the disputed amount, no member of the panel suggested that accrual should be based upon an estimate of the outcome of the litigation, although taxpayer's officers and tax counsel undoubtedly could have advanced such an appraisal.

The decision of the Tax Court is thus reversed on the Commissioner's petition and affirmed on the taxpayer's cross-petition.

Dissenting Opinion of United States Court of Appeals for the Second Circuit (Judge Friendly).

FRIENDLY, *Circuit Judge* (dissenting):

A current law review comment, under the heading "Tax Accounting: The Timing of Income and Deductions," has this to say: "While tax men are prone to refer to many parts of the tax law as a 'jungle,' it is to this area that the term is applied with the greatest force and frequency." Lyon, *Federal Income Taxation*, 35 N. Y. U. L. Rev. 697, 715 (1960). See also Freeman, *Tax Accrual Accounting for Contested Items*, 56 Mich. L. Rev. 727 (1958); Note, *Accrual: The Uncertain Concept of Certainty—A History of the All Events Test*, 21 U. Chi. L. Rev. 293 (1954).

This Court has recently taken important steps toward clearing the "jungle", see *Central Cuba Sugar Co.* v. *Commissioner*, 198 F. 2d 214 (2d Cir. 1952), *cert. denied*, 344 U. S. 874 (1952); *Bressner Radio, Inc.* v. *Commissioner*, 267 F. 2d 520 (2d Cir. 1959); *Consolidated Edison Co.* v. *United States*, —— F. 2d —— (2d Cir. 1960), as have other Courts of Appeals, *Harrold* v. *Commissioner*, 192 F. 2d 1002 (4th Cir. 1951); *Denise Coal Co.* v. *Commissioner*, 271 F. 2d 930 (3d Cir. 1959). This case affords an opportunity for further progress; I regret to see this lost.

Section 29.43-2 of Treasury Regulations 111 issued under the 1939 Code, which here controls, lays out the ground rules as follows:

> "Sec. 29.43-2. When charges deductible—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct

return. The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year: It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. * * * "

The thrust of the Regulation seems to be that the taxpayer must be industrious to "ascertain the facts" and to take "all authorized allowances" just as soon as he can. The Regulation warns him that "* * * if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he can not deduct them from the income of the next or any succeeding year." Anyone reading all this without the glosses, many of them inconsistent, that have been encrusted on it and its predecessors by courts and commentators, would suppose that an accrual basis taxpayer who took a deduction for expenses paid or

incurred which his auditors would require him to take in the taxable year, would be doing just what the Regulation adjured. I do not believe that any decisions of the Supreme Court or of this Court forbid us from applying the Regulation in that spirit to the Fifth Avenue Coach Lines.

Consider first the interest on the tax deficiencies for 1943-47. All the facts establishing the amount of the tax deficiencies and consequently of the interest thereon were determined in the Tax Court's decision of December 22, 1948, which found deficiencies for 1937-39. Before the end of 1948 taxpayer indicated its acquiescence in that determination by filing amended returns for 1940-42 and by paying the deficiencies and interest both for 1937-39 and for 1940-42. It is not suggested that the deficiencies for 1943-47 and the interest thereon stood on any different footing from those for the earlier years; the only reason why these also were not paid in 1948 was that time did not permit calculation of the exact amount due. However, it is settled that the absence of such a calculation during the calendar year, or even the inability to make one, does not destroy the deduction. *United States* v. *Anderson*, 269 U. S. 422, 441 (1926); *Continental Tie & Lumber Co.* v. *United States*, 286 U. S. 290, 297 (1932).

We are told that nevertheless the deduction must be denied because taxpayer had not formally advised the Commissioner during 1948 of its intention not to appeal, even though the Tax Court has found as a fact that taxpayer had acquiesced before the end of the year.[1] Yet, as

1 Reference is made to the minutes of a meeting of taxpayer's board of directors on February 26, 1949, recording that "Mr. Boykin C. Wright stated that after consultation with the officers of the Corporation in regard to the advisability of appealing from the decision of the Tax Court, he had recommended that the corporation should not appeal unless the Commissioner of Internal Revenue should appeal, in which case he believed that the Corporation should file a cross-appeal." To me this refers to advice given in December, 1948, by Mr. Wright, who

the majority recognize (fn. 3), actual payment of the deficiency and interest during 1948 would not have precluded an appeal, and I know of no authority that a letter announcing an intention not to appeal would have had any greater preclusive effect, at least if it were withdrawn sufficiently before the expiration of the three months' period, Internal Revenue Code of 1939, §1142, so that the Commissioner would not have been prejudiced by relying on it in making his own decision not to appeal. The effect of such a letter would thus have been only evidentiary. The Tax Court thought this additional evidence unnecessary to find that the dispute was no longer being contested, and its finding is entitled to the usual respect. *Casey* v. *Commissioner*, 267 F. 2d 26, 30-31 (2d Cir. 1959). The majority must thus be ruling that nothing short of a formal stipulation or the running of the time to appeal will suffice; I see nothing in the statute or regulations to warrant this. The only Supreme Court decisions that come near this phase of the case, *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516 (1944) and *Security Flour Mills* v. *Commissioner*, 321 U. S. 281 (1944), do not demand such a mechanical view: in those cases taxpayer was contesting liability all along and ultimately won. Neither do decisions in other Circuits, which, of course, do not bind us in any event. Although in

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had died before the Tax Court hearing, rather than meaning that this was his position, much less the company's, in February, 1949. Taxpayer's vice-president and comptroller testified that, after having conferred with counsel in December, 1948, he discussed the matter with the company's president, that they reached a definite decision not to appeal, that a government appeal would not have altered his own clusions not to appeal, and that despite a government appeal "we would still have gone through giving us [sic] the right to appeal when we made our decision to pay the deficiency and the interest accrued up until that time." Certainly the Tax Court's finding that "Petitioner had acquiesced in this Court's decision, and the liability for the interest was not being contested and was finally determined as of the end of 1948" was not clearly erroneous.

United States v. *Texas Mexican Ry.*, 263 F. 2d 31, 34 (5th Cir. 1959), Judge Wisdom makes the picturesque observation that "the existence of any liability is uncertain until the last bell is rung in the last court," the fact was that the taxpayer was vigorously contesting the liability, as in *Dixie Pine* and *Security Flour Mills. H. Liebes & Co.* v. *Commissioner*, 90 F. 2d 932 (9th Cir. 1937), is distinguishable since it involved the accrual of income by the taxpayer rather than a deduction, as here, and the person who had not decided whether to appeal was the party from whom the income would come; to analogize this to the instant case, where it was for the taxpayer to decide to give up, seems to confound the fisherman with the fish.

Although the deduction for the prospective wage liability is more questionable and perhaps would go beyond any case yet decided, I think that it is not forbidden by any authority binding upon us and that the taxpayer's position accords better with the statute and regulation than the Commissioner's. Any responsible auditor concerned with "the matching of costs and expenses against income," American Institute of Accountants. Audits by Certified Public Accountants, Their Nature and Significance (1950), p. 12, would have insisted on provision for this liability in the accounts for the years when the employees' services were rendered. Mr. Justice Brandeis said in *Brown* v. *Helvering*, 291 U. S. 193, 200 (1934), "that where a liability has 'accrued during the taxable year' it may be treated as an expense incurred; and hence as the basis for a deduction, although payment is not presently due * * * and although the amount of the liability has not been definitely ascertained." In my view taxpayer's "liability" for 1946 accrued at least by October 7, 1946, when it entered into an agreement with the union that any new contract would be retroactive to October 1, 1946, and its "liability" for 1948 accrued on January 26, 1948, when the taxpayer and the

union agreed that any contract would be retroactive to February 1, 1948. To be sure, the amount of the liability was uncertain; in theory it might have proved to be zero, but in theory only, however much taxpayer may have desired this result and even have gone through the motions of seeking to accomplish it. Average hourly earnings for street railway and bus workers had increased by 5¢ per hour from March, 1946, the date of the last determination between taxpayer and its workers, to September, 1946, Bureau of Labor Statistics, Monthly Labor Review, and the Consumer Price Index had rocketed from 130.2 to 146. Again, from the arbitrator's award in June, 1947, to January, 1948, average hourly earnings in the industry climbed another 8.7¢ and the Consumer Price Index from 157 to 169. To compare negotiations or arbitrations over wages with litigations over taxes or other contested liabilities appears quite as unrealistic as a similar attempt at analogizing labor arbitration provisions with those in other types of contracts was recently held to be, *United Steelworkers of America* v. *Warrior and Gulf Navigation Co.*, —— U. S. —— (1960).

No decision of the Supreme Court or of this Court seems to me to require a disallowance here. The deduction disallowed in *Brown* v. *Helvering*, *supra*, was for the establishment of a reserve against income which taxpayer feared might not remain his; *Lucas* v. *American Code Co.*, 280 U. S. 445 (1930), involved contested damages for the breach of an executory contract for personal services for 18 years prospective duration; *Dixie Pine Products Co.* v. *Commissioner*, *supra*, and *Security Flour Mills* v. *Commissioner*, *supra*, and *Automobile Club* v. *Commissioner*, 353 U. S. 180, 188-90 (1957), rested on the lack of proof that taxpayer's method of spreading the dues income properly reflected the facts, as this Court recognized in *Bressner*

Radio, Inc. v. *Commissioner, supra,* at 528. Unless *Spencer, White & Prentis* v. *Commissioner,* 144 F. 2d 45 (2d Cir. 1944), *cert. denied,* 323 U. S. 780 (1944), is similarly distinguishable, it is inconsistent with *Bressner Radio.* Here the employees had rendered the services during the taxable year; the company owed for these services whatever sums negotiation or arbitration might determine; and it had a very shrewd idea what its bill would be, as witness the absolute accuracy of its estimates. This was not happenstance. Persons concerned with labor matters keep themselves well informed of the trend of wage settlements and arbitrations and the industry pattern is fairly consistent. All that is required is a reasonable estimate; indeed, that is all we actually have for a great many items in corporate financial statements, despite their appearance of exactness.[2] If the law requires deduction of such a liability on an estimated basis in the year in which the liability is incurred, as I think it does, the taxpayer does not have the free election between years that the majority assumes, and I doubt the nation will perish if taxpayers do have it within their power to overshoot or undershoot the deduction for wages in a particular year by a few cents per hour. Certainly, in an inflationary economy[3] the deduction of a reasonable estimate of this expense comes far closer to the clear reflection of income demanded by §41 of the 1939 Code than making none. In *Consolidated Edison Co.* v. *United States, supra,*

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2 "Actually, the values of most items in financial statements cannot be measured exactly. By their nature, many of the amounts shown have to be approximations and represent the best estimate which those responsible for the statements can make." American Institute of Accountants, Audits by Certified Public Accountants, Their Nature and Significance (1950), p. 10.

3 For the ten-year period, 1949-59, the annual rate of depreciation of the dollar (compounded), determined by reciprocals of the consumer price index, has been 2%. See First National City Bank Monthly Letter, July, 1960.

this Court allowed a taxpayer to deduct an amount estimated, on no more scientific a basis, to be its liability for city taxes in the year in which these accrued as against the government's contention that it must deduct the full amount assessed. I grant that the Consolidated Edison Co. did not challenge the city's right to the estimated tax whereas here the practicalities of labor negotiation and arbitration forced the Fifth Avenue Coach Lines to assume a more bellicose stance, although it knew full well that this posture would not prevail and recorded its true views of its liability on its books, as good accounting practice required. I do not think the difference requires a different result; in tax matters particularly, substance should prevail.

I would affirm on the Commissioner's petition and reverse on taxpayer's cross-petition.

Judgment of United States Court of Appeals for the Second Circuit.

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the twenty-ninth day of July one thousand nine hundred and sixty.

Present:

HON. THOMAS W. SWAN,
HON. CHARLES E. CLARK,
HON. HENRY J. FRIENDLY,
Circuit Judges.

COMMISSIONER OF INTERNAL REVENUE
Petitioner,
v.
FIFTH AVENUE COACH LINES
Respondent.

FIFTH AVENUE COACH LINES
Petitioner,
v.
COMMISSIONER OF INTERNAL REVENUE
Respondent.

Appeals from The Tax Court of the United States.

This cause came on to be heard on the transcript of record from The Tax Court of the United States

and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed as to the Commissioner of Internal Revenue's petition and affirmed as to the taxpayer Fifth Avenue Coach Lines' cross petition.

A. DANIEL FUSARO, Clerk

NIALL F. O'DOHERTY

No. 634

In the Supreme Court of the United States

OCTOBER TERM, 1960

FIFTH AVENUE COACH LINES, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MEMORANDUM FOR THE RESPONDENT

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COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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MEMORANDUM FOR THE RESPONDENT

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 155-192) are reported at 31 T.C. 1080. The opinion of the Court of Appeals (R. 200-220) is reported at 281 F. 2d 556.

JURISDICTION

The judgment of the Court of Appeals was entered on July 29, 1960. (R. 221-222.) A petition for rehearing was filed in August 12, 1960 and denied on October

10, 1960. (R. 223, 236-237, 239.) The petition for a writ of certiorari was filed on January 7, 1961. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether taxpayer (filing its returns on the calendar year-accrual basis) was required by Section 43 of the Internal Revenue Code of 1939 to accrue and deduct unpaid interest on contested tax deficiencies in the taxable year in which the decision sustaining the deficiencies became final by virtue of the expiration of the time to appeal, rather than in the taxable year in which the decision was entered.

2. Whether the taxpayer was required by Section 43 of the Internal Revenue Code of 1939 to accrue and deduct retroactive wage increases to its employees in the years such increases were determined to be due by arbitration awards, rather than in prior years during which the taxpayer contested and refused to pay the claimed increases.

STATUTES AND REGULATIONS INVOLVED

The statutes and Treasury Regulations involved are set forth in the Appendix, *infra*, pp. 14-18.

STATEMENT

1. Interest Accrual Issue

On December 22, 1948, the Tax Court formally entered a decision in *New York City Omnibus Corp.* v. *Commissioner* (1948 P-H T.C. Memorandum Decisions, par. 48,254), pursuant to a memorandum opinion rendered November 30, 1948. In that decision, deficiencies

were found in the taxpayer's taxes for the years 1937 to 1939 inclusive, based upon "voluminous conflicting evidence". Among other things, the cost basis for amortization purposes of the company's bus franchise and the useful life of buses for depreciation purposes were determined. These determinations, if not appealed from, would also affect the taxpayer's income and excess profits tax liability for the years 1940 through 1947. (R. 170.)

Prior to December 31, 1948, the taxpayer's comptroller-vice president, conferred—after consulation with tax counsel—with the taxpayer's president on the advisability of an appeal. They agreed that an appeal should not be taken. (R. 170.) On December 29, 1948, the taxpayer filed amended federal income and excess profits tax returns for the years 1940 through 1942, revising its deductions and reporting the adjustments made necessary in order to conform the returns to the Tax Court's decision of December 22, 1948. (R. 171-172.)

In a letter dated December 30, 1948, the taxpayer's counsel transmitted four checks to the Collector of Internal Revenue to pay its deficiencies for the years 1937 to 1942, inclusive. (R. 171.) Nothing was remitted in 1948 with respect to the deficiencies for the years 1943 to 1947. The deficiencies for the years 1940, 1941, and 1942 were assessed and paid on December 31, 1948. The deficiencies for the years actually involved in the litigation, 1937 through 1939, were not assessed and the checks not applied thereto until April 1, 1949, the sums applicable to those years being held in the Collector's suspense account. (R. 172.)

On December 31, 1948, the taxpayer computed and accrued on its books the amounts of the deficiencies and

interest for the years 1943 to 1947 determined to be due in accordance with the Tax Court's opinion. And in its income tax return for the year 1948, filed March 15, 1949, the taxpayer deducted $109,802.30, the amount of interest thus accrued on the books, although no assessment or payment had yet been made with respect to these years. (R. 172.)[1]

Neither the taxpayer nor the Commissioner appealed from the decision of the Tax Court rendered December 22, 1948. (R. 172.) That decision therefore became final (*i.e.*, non-appealable) on March 22, 1949. See Sections 1140 and 1142 of the Internal Revenue Code of 1939.

The minutes of the meeting of the taxpayer's board of directors, held on February 25, 1949 (R. 153, 170), refer to a statement by Boykin C. Wright, a member of taxpayer's board of directors and of the law firm which served as its tax counsel, to this effect: that, after consulting with the taxpayer's officers in regard to the advisability of appealing the 1948 Tax Court decision, he had suggested that the taxpayer not appeal, unless the Commissioner appealed, in which event he believed that the taxpayer should file a cross appeal. This meeting was the first meeting of the board since December 9, 1948. It is not known whether Wright conferred with the officers before or after December 31, 1948. The minutes do not disclose any further discussion at the meeting. (R. 152-154, 170-171.) Wright was not alive when the case below was tried. (R. 46.) The Commissioner made no decision prior to

[1] The deduction thus claimed entered into a net operating loss in 1948 which the taxpayer sought to carry back to prior years. (R. 64-65, 156).

January 1, 1949, whether or not to appeal the court's decision. (R. 171.)

The Commissioner disallowed the deduction for interest of $109,802.30 claimed for the year 1948, on the ground that the liability therefor was not finally determined before the end of the year. (R. 173.) The Tax Court (Judge Harron dissenting) overruled the Commissioner, holding that the taxpayer's liability for the interest had been finally adjudicated as of the end of 1948. (R. 183-192.) The Court of Appeals (one judge dissenting) reversed. (R. 200-220.)

2. Wage Accrual Issue

Prior to 1946, the taxpayer and the Union representing its employees had negotiated several employment contracts, the first of which was executed on July 22, 1937. In August, 1946, the unions presented demands for a new contract and wage increases to become effective on October 1, 1946, upon expiration of the then outstanding contract. (R. 163.)

On October 7, 1946, an agreement between the Union and the taxpayer was signed which provided that any subsequent labor contract resulting from the negotiations would be retroactive to October 1, 1946. Taxpayer's employees continued to work and receive payment at the rates provided in the expired contract. Negotiations over the terms of the new contract were not concluded by December 31, 1946. (R. 163.)

Some time prior to March, 1947, the taxpayer closed its books for the year 1946 and accrued the additional wages which its officers estimated to be due and owing to its employees for their services from October 1 to December 31, 1946. (R. 163.) The additional wages were estimated by the taxpayer's officers on the basis

of their experience, the wages being paid in the industry, the increased cost of living, and other relevant facts as they existed on October 1, 1946. (R. 163-164.) To conceal these estimates from its union bookkeeping employees, the accruals of these amounts were included among legal expenses. (R. 164.)

The amount accrued for additional wages due to the employees, $83,226.52, was computed at the rate of six cents per hour and was included in the deduction for wages in taxpayer's tax return filed on March 15, 1947. (R. 164.)

Taxpayer and the Union failed to negotiate a mutually satisfactory agreement; accordingly, on March 7, the parties agreed to submit the matter to arbitration. Resort to arbitration in the event that direct negotiations proved unsuccessful was taxpayer's customary practice. One of the issues submitted to arbitration was the amount, if any, of a retroactive wage rate increase to be paid for the period October 1, 1946, through the end of the new contract period. The proceedings before the arbitrator required 22 days of hearings. (R. 164.) The taxpayer's position throughout these hearings was that the Union employees were not entitled to any retroactive wage increase and that an increase was not justifiable under any economic theory advanced by the Union. (R. 51, 164.) On June 18, 1947, the arbitrator promulgated his award binding on both parties fixing the wage increase at an average of six cents per hour, the amount already accrued by taxpayer. In 1947, taxpayer paid these additional wages covering services rendered by its employees from October 1 to December 31, 1946. (R. 164-165.)

On December 19, 1947, the Union again served demands for increased wages and other benefits, to take

effect January 31, 1948, upon expiration of the period covered by the previous arbitration award. (R. 167.) On January 26, 1948, the taxpayer and the Union concluded an agreement, similar to the contract of October 7, 1946, providing that any labor contract subsequently concluded between the parties would be retroactive to February 1, 1948. As in the previous negotiations, taxpayer continued to pay the wage rates fixed by the terms of the previous contract pending agreement as to the amount of the increase. During these negotiations, the taxpayer consented to pay a wage increase effective May 1, 1948, conditioned upon the city's granting a fare increase. This the city did, and the taxpayer paid that wage increase in 1948. (R. 167.)

The Union continued to press its demands for additional compensation for the period February 1 to April 30, 1948. (R. 167.) As of December 31, 1948, the Union and the taxpayer were unable to agree on the question of a wage rate increase for that period, and an arbitrator was appointed on March 1, 1949, to decide the matter. (R. 168.) The taxpayer maintained before the arbitrator that there was no justification for granting any wage rate increase. (R. 168.)

The taxpayer did not accrue on its books any amount as an estimate of this retroactive wage increase. However, the taxpayer's officers did estimate such an amount to be ten cents an hour prior to the filing of the taxpayer's 1948 income tax return on May 13, 1949. The amount of the liability thus claimed on the 1948 return as an accruable deduction attributable to 1948 operations was $112,600 based on an estimated increase in the wage rate of ten cents per hour. (R. 168.)

On May 30, 1949, the arbitrator awarded an increase of ten cents per hour, the amount previously deducted

in the taxpayer's income tax return. The taxpayer paid these additional wages for 1948 services in 1949. Regarding the question of the wage increase, the arbitrator considered and weighed the same or similar factors as did the prior arbitrator. (R. 168.)

The Commissioner disallowed the deductions for retroactive wage increases claimed for the years 1946 and 1948, on the ground that during those years taxpayer refused to pay and was still contesting its liability to pay any part of such increases. The Tax Court unanimously sustained this determination. (R. 179-183.) The Court of Appeals (one judge dissenting) affirmed. (R. 200-220.)

DISCUSSION

1. The decision of the court below on both issues is in accord with principles of tax accounting declared by this Court. *E.g., Dixie Pine Co.* v. *Commissioner*, 320 U.S. 516; *Security Mills Co.* v. *Commissioner*, 321 U.S. 281; *United States* v. *Anderson*, 269 U.S. 422. Taxable income must be computed on an annual accounting basis, *i.e.*, each "taxable year" is treated as a separate independent unit. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359, 363-365; *Heiner* v. *Mellon*, 304 U.S. 271, 275; *Brown* v. *Helvering*, 291 U.S. 193; *Lewyt Corp.* v. *Commissioner*, 349 U.S. 237, 242. The proper taxable year for accrual of a deductible item is the year in which the liability of the taxpayer to pay it becomes fixed, both in fact and amount. *Dixie Pine Co.* v. *Commissioner, supra*; *Security Mills Co.* v. *Commissioner, supra*. Consequently, a contingent liability does not accrue as a deduction until the contingency is removed (*Lucas* v. *American Code Co.*, 280 U.S. 445; *Brown* v. *Helvering, supra*), and an unpaid contested

liability remains contingent and non-accruable until the contest is settled (*Dixie Pine Co.* v. *Commissioner, supra; Security Mills Co.* v. *Commissioner, supra*). In holding that the unpaid and contested liabilities here involved were not accruable and deductible until the taxable years in which the contests were terminated, the court below reached the only conclusion consistent with the above decisions.

a. Taxpayer's obligation to pay interest on tax deficiencies for the years 1943-1947 was dependent upon the ultimate resolution of its Tax Court litigation in *New York City Omnibus Corp.* v. *Commissioner, supra.* Although the decision of the Tax Court in that case was entered on December 22, 1948, it did not become final until the time to appeal expired three months later (March 22, 1949). Section 1140 of the Internal Revenue Code of 1939. See also, *H. Liebes & Co.* v. *Commissioner*, 90 F. 2d 932 (C.A. 9th); and *United States* v. *Texas Mexican Railway Co.*, 263 F. 2d 31, 34 (C.A. 5th). Consequently, the court below properly held that taxpayer's liability therefor accrued in the calendar year 1949 and had been improperly deducted in its 1948 return.

Taxpayer assumes (Pet. 10-11) that its obligation to pay the deficiency interest in question became fixed in December of 1948, because two of its officers then "decided" not to appeal from the deficiency judgment. But the date of accrual of a litigated liability is the date when the matter is "finally adjudicated". *Dixie Pine Co.* v. *Commissioner,* 320 U.S. at 519. This did not take place in 1948 since taxpayer did not relinquish its right to appeal by notifying the Commissioner of acquiescence in the Tax Court's decision. As the

court below pointed out (R. 203-205), adoption of the subjective expectancy-of-appeal test advocated by taxpayer would permit litigants to choose the years of deductibility; indeed, as the court also observed (R. 205), "The opportunity for manipulation is enhanced where, as here, taxpayer relies primarily upon evidence of private conversations among its officers, uncommunicated to any third party".

Consolidated Edison Co. of New York v. *United States*, 279 F. 2d 152 (C.A. 2d), certiorari granted, 364 U.S. 890 (No. 357, this Term), upon which taxpayer relies (Pet. 11), was decided by the same court which decided this case, and was properly distinguished by it (R. 212). The question there involved is whether a contested liability accrues when *discharged by payment* made under protest. In this case, the taxpayer did not pay the disputed interest in 1948. (R. 172.)

b. The retroactive wage increases awarded to taxpayer's employees by the arbitrator in 1947 and 1949, for services rendered during part of 1946 and 1948, respectively, were vigorously contested by taxpayer during the latter years, and were likewise non-accruable in those years. *Dixie Pine Co.* v. *Commissioner, supra; Security Mills Co.* v. *Commissioner, supra.* It is irrelevant that taxpayer was not litigating the wage claims in a judicial proceeding. Taxpayer refused to grant any wage increase, and its contest with the Union was of sufficient substance that it was ultimately necessary to submit the matter to arbitration. Its liability was accordingly too contingent to be accrued as a federal tax deduction. Cf. *General Communication Co.* v. *Commissioner*, 33 T.C. 640.

It is of no consequence that taxpayer accurately forecast, in 1946 and 1948, the amount of its then contingent liability for wages. Where the *fact* of liability is fixed, several courts have allowed deductions for reasonably accurate estimates of the *amount* of that liability. *E.g., Denise Coal Co.* v. *Commissioner*, 271 F. 2d 930 (C.A. 3d); *Harrold* v. *Commissioner*, 192 F. 2d 1002 (C.A. 4th). However, taxpayer's liability itself was contested and contingent and, therefore, could not be accrued. *Lucas* v. *American Code Co., supra; Brown* v. *Helvering, supra.* It may be that taxpayer, like many litigants, recognized the improbability of complete success in its contest, or, like many prudent businessmen, was merely establishing a reserve for future contingent expenses. In either event, it could not claim that it owed no wage increases to its employees and simultaneously take a deduction therefor. *Dixie Pine Co.* v. *Commissioner, supra; Brown* v. *Helvering, supra.*

Taxpayer asserts (Pet. 12) that the decision of the Court of Appeals for the Seventh Circuit in *Milwaukee & Suburban Transport Corp.* v. *Commissioner*, 283 F. 2d 279, is in conflict with the decision below on the wage accrual issue. However, the Seventh Circuit took pains to distinguish situations similar to that here involved. In *Milwaukee & Suburban*, the court allowed the operator of a public transportation system to accrue as federal tax deductions the estimated amounts of its contested liability for numerous tort claims arising out of accidents occuring within the taxable year. The court expressly noted (p. 286) that normally "a contested claim is not deductible." However, the court held (pp. 286-287) that although that rule applied where a single claim was involved, it was inapplicable

to a large number of claims the liability for which could be predicted with reasonable accuracy. The court reasoned that the taxpayer there held a position similar to that of an insurance company, *viz.*, each individual claim against it would be too contingent as to payment and too uncertain as to amount to permit deduction, but the aggregate of those claims was susceptible of computation under actuarial principles. Regardless of whether the court was correct in making that distinction, it does not apply here. The determination of the respective wage increases for 1946 and 1948 were, in effect, single claims which, even under the rationale of *Milwaukee & Suburban,* were too contingent to be accrued as tax deductions in those years.

2. Although we believe, for the reasons set forth above, that the decision below is in full accord with the decisions of this Court, the tax accounting questions here presented do bear some relationship to those involved in two cases which are now awaiting argument before this Court. *United States* v. *Consolidated Edison Co.*, No. 357; *American Automobile Assn.* v. *United States*, No. 288. The questions are also related to those involved in three cases now pending on petition (*New Jersey Automobile Club* v. *United States* (No. 140); *Streight Radio and Television, Inc.* v. *Commissioner* (No. 507); *Commissioner* v. *Schlude* (No. 629)),[2] all of which are apparently being held in abeyance to await the outcome of the *Consolidated Edison* and *Automobile Assn.* cases. We presume therefore

[2] See, also, *Milwaukee & Suburban Transport Corp.* v. *Commissioner*, *supra*, in which the Government is contemplating the filing of a protective petition for certiorari, to await the outcome of the *American Automobile Assn.* and *Consolidated Edison* cases.

that the Court will also deem it appropriate to hold the instant petition.

Respectfully submitted,

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MARCH, 1961

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * * * * *

(b) *Interest.*—All interest paid or accrued within the taxable year on indebtedness, * * *.

* * * * * * * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U.S.C. 1952 ed., Sec. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

(a) *Taxable Year.* "Taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. * * *

* * * * * * * * *

(c) *"Paid or Incurred," "Paid or Accrued."* The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * * * * * * *

(26 U.S.C. 1952 ed., Sec. 48.)

SEC. 1140. DATE WHEN TAX COURT DECISION BECOMES FINAL.

The decision of the Tax Court shall become final—

(a) *Petition for Review not Filed on Time.*— Upon the expiration of the time allowed for filing a petition for review, if no such petition has been duly filed within such time; * * *

* * * * * * * * *

(26 U.S.C. 1952 ed., Sec. 1140.)

SEC. 1142. PETITION FOR REVIEW.

The decision of the Tax Court rendered after February 26, 1926 * * * may be reviewed by a court of appeals, or the United States Court of Appeals for the District of Columbia, as provided in section 1141, if a petition for such review is filed by either the Commissioner or the taxpayer within three months after the decision is rendered, * * *.

(26 U.S.C. 1952 ed., Sec. 1142.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> Sec. 29.41-1. *Computation of Net Income.*—Net income must be computed with respect to a fixed period. Usually that period is 12 months and is known as the taxable year. Items of income and of expenditure which as gross income and deductions are elements in the computation of net income need not be in the form of cash. It is sufficient that such items, if otherwise properly included in the computation, can be valued in terms of money. The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income. If the method of accounting regularly employed by him in keeping his books clearly reflects his income, it is to be followed with respect to the time as of which items of gross income and deductions are to be accounted for. * * *
>
> Sec. 29.43-1. *"Paid or Incurred" and "Paid or Accrued."*—(a) The terms "paid or incurred" and "paid or accrued" will be construed according to the method of accounting upon the basis of which the net income is computed by the taxpayer. (See section 48(e).) The deductions and credits provided for in chapter 1 (other than the dividends paid credit provided in section 27) must be taken for the taxable year in which "paid or accrued" or "paid or incurred," unless in order clearly to reflect the income such deductions or credits should be taken as of a different period. If a taxpayer desires to claim a deduction or a credit as of a period other than the period in which it was "paid or accrued" or "paid or incurred," he shall attach to his return a statement setting forth

his request for consideration of the case by the Commissioner together with a complete statement of the facts upon which he relies. However, in his income tax return he shall take the deduction or credit only for the taxable period in which it was actually "paid or incurred," or "paid or accrued," as the case may be. Upon the audit of the return, the Commissioner will decide whether the case is within the exception provided by the Internal Revenue Code, and the taxpayer will be advised as to the period for which the deduction or credit is properly allowable.

* * * * * * * * *

Sec. 29.43-2. *When Charges Deductible.*—Each year's return, so far as practicable, both as to gross income and deductions therefrom, should be complete in itself, and taxpayers are expected to make every reasonable effort to ascertain the facts necessary to make a correct return. The expenses, liabilities, or deficit of one year cannot be used to reduce the income of a subsequent year. A taxpayer has the right to deduct all authorized allowances, and it follows that if he does not within any year deduct certain of his expenses, losses, interest, taxes, or other charges, he cannot deduct them from the income of the next or any succeeding year. It is recognized, however, that particularly in a going business of any magnitude there are certain overlapping items both of income and deduction, and so long as these overlapping items do not materially distort the income they may be included in the year in which the taxpayer, pursuant to a consistent policy, takes them into his accounts. Judgments or other binding adjudications, such as decisions of referees and boards of review under workmen's compensation laws, on account of damages for patent infringement, personal injuries, or

other cause, are deductible from gross income when the claim is so adjudicated or paid, unless taken under other methods of accounting which clearly reflect the correct deduction, less any amount of such damages as may have been compensated for by insurance or otherwise. * * *

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